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In The

SUPREME COURT OF THE UNITED STATES

October Term, 1969

No. 150

CALIFORNIA STATE BOARD OF EQUALIZATION,

Petitioner,

vs.

RICHARD A. CARLSON,

Respondent.

RESPONDENTS' ANSWERING BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

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OPINION BELOW, JURISDICTION, AND STATEMENT OF THE CASE

Counsel for petitioner has fairly set forth the opinions below, the jurisdiction of the Court as invoked, the statements involved and a statement of facts in the case.

REASONS FOR DENYING THE WRIT

However, it is respectfully submitted that certiorari should not be granted in this case. As was pointed out in the matters of WALTER R. BRAUND and VIRGINIA M.

BRAUND, bankrupts; UNITED STATES OF AMERICA, Appellan vs. WILLIAM A. McGUGIN, Appellee, 423 F. 2d 718:

"It is crystal clear that one of the principal purposes of the 1966 amendment was to aid in the rehabilitation of bankrupts by relieving them of certain older tax liability. The House Judiciary Committee, in its favorable report on House Bill, H.R. 3438 (H.R. Rep. No. 687, 89th Cong. 1st Sess. 1965) which favorable report was also quoted by the Senate Judiciary Committee on its recommendation of the bill, (S. Rep. No. 1158, 89th Cong., 2nd Sess. 1966; U.S. Code Cong. Adm. News 2468 (1955)), discuss the previous non-dischargeability of tax liability. It goes on to say:

> 'Frequently this prevents an honest but financially unfortunate debtor from making a fresh start unburdened by what may be an overwhelming liability for accumulated taxes * * * Furthermore, the non-dischargeability feature of the law operates in a manner which is unfairly discriminitory against the private

individual or the unincorporated small businessman. Although a corporate bankrupt is theoretically not discharged, the corporation normally ceases to exist upon bankruptcy and unsatisfied tax claims, as well as all other unsatisfied claims, are without further recourse even though the enterprise may continue in a new corporate form. (Emphasis Added)

U.S. Code Cong. Adm. News 2469 (1966).'"

Further reading in the same case, we find the following:

" . . . . In other words, Congress was saying that to the extent the lien had, before the bankruptcy, attached to property a later discharge in bankruptcy did not affect the right of the government to proceed against that property under the lien. To that extent, but to that extent only, the discharge would not 'release or affect' the tax lien. But if the tax liability is not paid in full by the proceeds of such property, the remainder of the tax liability is 'released' and no afteracquired property can be subjected to any lien because the lien died with the

release of the underlying obligation.

Support for this construction is found in the same House Judiciary Committee report cited above:

> 'While, under this bill, unsecured tax claims due and owing more than 3 years prior to bankruptcy would be dischargeable, there is no intention to place any time limit on otherwise valid tax liens. As with other secured claims like mortgages and conditional sales contracts, the purpose of the lien is to give the creditor a property interest which is indefeasible in bankruptcy. Thus to the extent that the tax authorities may satisfy their claims out of the security they hold they will be unaffected by the discharge regardless of the fact that the underlying debt may include taxes for years prior to the 3-year period preceding bankruptcy. The second proviso to section 17a(1) proposed by section 2 of this bill emphasizes this legislative intent * * * (Emphasis

added) Id. at 2470.'

Note the concern that the property interest of the government obtained pursuant to the lien up to the time of the filing of the bankruptcy should be 'indefeasible' in the bankruptcy. Note also the assurance that the right of the tax authorities to realize on the 'security they hold' as of the time of the bankruptcy should be 'unaffected by the discharge'.

I construe the section in question as above indicated. The same construction has been given to it by Professor Frank R. Kennedy, a member of the National Bankruptcy Conference. See Kennedy, op. cit., supra at 179." *

Since the decision in the instant case, as well as in the matter of BRAUND, supra, the 7th Circuit has likewise spoken on the same subject. In the Matter of UNITED STATES OF AMERICA vs. SANABRIA, ET AL., (U.S. Court of Appeals, 7th Circ. No. 17145, April 28, 1970. Appeal from the United States District Court, Northern District

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* It is only fair, however, to point out that a petition for Writ of Certiorari has been filed by the Solicitor General of the United States in respect to the Matter of Braund.

of Illinois, Eastern Division. That case is set forth in full in the Appendix.

As was pointed out in the instant case, there are substantial arguments on both sides. But the Circuit thought on balance the results reached in this decision was the better one.

In the matter of SANABRIA, supra, the Court states as follows:

> "The legislative history is more fully described in those decisions. At the very best for the government, portions of the history are ambiguous. Several statements of Senators, relied on by the government, which might possibly be construed to support the government position, never really make it clear that the speaker was addressing himself to an effect of the federal lien on property acquired after bankruptcy, or asserting more than that a lien, recorded before bankruptcy, would retain its full effect upon property interests which became subject to it before bankruptcy."

CONCLUSION

It is respectfully submitted, that the petition for Writ of Certiorari in the above entitled matter should be denied.

Respectfully submitted,

SLATE AND LEONI

By _____
Attorneys for Respondent

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[§63,506] UNITED STATES OF AMERICA v. SANABRIA, ET AL.

United States Court of Appeals, Seventh Circuit. No. 17145. April 28, 1970. Appeal from United States District Court, Northern District of Illinois, Eastern Division.

TAXES--EFFECTIVENESS OF LIEN--PROPERTY ACQUIRED AFTER DISCHARGE

The government was not entitled to a lien for unpaid income taxes on property acquired by the discharged debtor after his bankruptcy since the 1966 amendment to section 17(a) of the Bankruptcy Act precludes the enforcement of liens for unpaid taxes which were legally due and owing more than three years prior to bankruptcy. The appellate court rejected the government's interpretation of the applicable statute (26 U.S.C. §6321) regarding the vitality of the lien since the dominant purpose of the change was to relieve a debtor of the burden of the older taxes after bankruptcy. See Sec. 17(a) at §4142.

Before Duffy, Senior Circuit Judge, FAIRCHILD, Circuit Judge, and BEAMER, District Judge.[1]

[OPINION IN FULL TEXT]

FAIRCHILD, Circuit Judge: The question on this appeal is whether a discharge in bankruptcy after the 1966 amendment to section 17(a) of the bankruptcy act prevents the lien for unpaid federal income taxes which became legally due and owing more than three years preceding bankruptcy from attaching to property acquired by the discharged debtor after bankruptcy.

[FACTS]

The government brought action against three defendants named Sanabria to recover unpaid income taxes. Two defendants averred discharges in bankruptcy, releasing them from liability for those taxes which had become legally due and owing more than three years before bankruptcy.

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[1] District Judge Beamer is sitting by designation from the Northern District of Indiana.

The government replied that liens arising on account of those taxes had been appropriately filed with the local recorder of deeds before the bankruptcy proceedings.

The district court granted judgment in favor of defendants with respect to the taxes allegedly discharged, and the government appealed.

[GOVERNMENT'S CLAIM]

The position of the government appears to be that although the taxes involved on this appeal are of sufficient age to be discharged as debts, the liens which arose and notices of which were filed retain sufficient vitality so that if the bankrupt defendants acquire property in the future it will be subject to those liens.

The bankruptcy proceedings were begun about the same time as the government brought its action to recover the taxes. Presumably the government now seeks a declaration that its liens arising out of the taxes outstanding more than three years retain such vitality, notwithstanding the discharge.

Under section 17(a) of the bankruptcy act,[2] prior to amendment in 1966, a discharge in bankruptcy did not release a bankrupt from a debt "due as a tax levied by the United States, or any state, county, district, or municipality." Clause (1) so described one of the types of provable debt not affected by a discharge.

Public Law 89-496[3] was enacted July 5, 1966, effective 90 days later. It amended clause (1) of section 17(a) so as to limit the class of taxes not dischargeable to "taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy" and to taxes under other specified sets of circumstances usually involving some failure to act or fault with respect to the tax liability on the part of the bankrupt. As a result of this restriction of clause (1), federal, state, and local taxes not described in clause (1) have been made dischargeable in bankruptcy.

At the end of clause (1) is a proviso which is the focal point of this controversy: "And provided further, That a discharge in bankruptcy shall not release or affect

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[2] 11 U.S.C. §35(a).
[3] 80 Stat. 270

any tax lien." The proviso means at least that a taxing authority's lien upon property already subjected to the lien at the time of bankruptcy is not released or affected by the discharge even where the tax which gave rise to the lien became legally due and owing more than three years before bankruptcy.

[GOVERNMENT'S CONTENTION]

The government contends that the proviso means something more, so that it will have a drastic impact upon the debtor during the period following bankruptcy.

The lien for unpaid federal income tax has a quality by which property acquired by a delinquent taxpayer after his tax liability arises and at any time during the life of the lien becomes subject to the lien.[4] The lien imposed by 26 U.S.C. §6321 continues until the liability is satisfied or becomes unenforceable by reason of lapse of time.[5]

The government would read the proviso as preserving this quality, where the lien had been filed before bankruptcy, into the period after bankruptcy, so that such lien would attach to property acquired by the debtor after bankruptcy.

[PURPOSE OF SECTION 17(a)]

But a fair reading of section 17(a), as amended, shows, in our opinion, that the dominant purpose of the change was to relieve a debtor of the burden of these older taxes after bankruptcy. The government's interpretation would permit it to enforce (to the extent of assets acquired by the discharged debtor) collection of all its taxes, regardless of their age, if a lien had been filed. This would to so substantial a degree frustrate the real purpose of the amendment that Congress surely must not have intended the result.

In considering a situation, which, though different, suggests some of the same considerations, the Supreme Court said:

"An adjudication of bankruptcy, followed by a discharge, releases a debtor from all previously incurred debts, with certain exceptions not pertinent here; and it

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[4] Glass City Bank v. United States (1945), 326 U.S. 265, 268, 66 SCt. 108, 90 LEd. 56, 59.
[5] 26 U.S.C. §6322.

logically cannot be supposed that the act nevertheless intended to keep such debts alive for the purpose of permitting the creation of an enforceable lien upon a subject not existent when the bankruptcy became effective or even arising from, or connected with, pre-existing property but brought into being solely as the fruit of the subsequent labor of the bankrupt."[6]

The Court went on to say that one of the primary purposes of the bankruptcy act, to permit the honest debtor to start afresh, "has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clean field for future effort, unhampered by the pressure and discouragement of pre-existing debt."[7]

[COMMITTEE REPORT]

The expressions just quoted were echoed in a committee report on the bill which provided for the amendment to section 17(a):

"Although taxes have enjoyed this special status for many years, the enormous increase in the tax burden during recent years and the consequent impact on both the distribution of a bankrupt's estate and his financial rehabilitation, require a modification of that status.

"There are two aspects to the problem. The first of these involves the nondischargeability of taxes under section 17a(1) of the present law. Frequently, this prevents an honest but financially unfortunate debtor from making a fresh start unburdened by what may be an overwhelming liability for accumulated taxes. The large proportion of individual and commercial income now consumed by various taxes makes the problem especially acute. Furthermore, the nondischargeability feature of the law operates against the private individual or the unincorporated small businessman. Although a corporate bankrupt is theoretically not discharged, the corporation normally ceases to exist upon bankruptcy and unsatisfied tax claims, as well as all other unsatisfied claims, are without further recourse even though the enterprise may continue in a new corporate form."[8]

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[6] Local Loan Co. v. Hunt (1934), 292 U.S. 234, 243, 54 SCt. 695, 78 LEd. 1230, 1235.

[7] Ibid.

[8] S.Rep.No. 1158, 89th Cong., 2d Sess. (1966), 2468, 2469.

Several district courts have decided that liens which arose from taxes which are discharged in bankruptcy under amended section 17(a) remain effective only upon assets existing as of the date of bankruptcy.[9]

The legislative history is more fully described in those decisions. At the very best for the government, portions of the history are ambiguous. Several statements of Senators, relied on by the government, which might possibly be construed to support the government position, never really make it clear that the speaker was addressing himself to an effect of the federal lien on property acquired after bankruptcy, or asserting more than that a lien, recorded before bankruptcy, would retain its full effect upon property interests which became subject to it before bankruptcy.

The judgment is affirmed.

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[9] In re Carlson (C.D.Cal., 1968), 292 FSupp. 778, 782; In re Joseph Luks, Bankrupt (N.D.Ohio, 1968) 68-2 USTC §9549; In re Braund (C.D.Cal., 1968), 289 FSupp. 604. See Kennedy, The Bankruptcy Amendments of 1966, 1 Ga. L.Rev. 149, 179, and fn. 122 (1967).